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Poland: Can It Survive Until 1984?

There will be two key elements in Poland's future economic and political stability: (1) an austerity and reform program which stabilizes and then revives the Polish economy; and (2) continued foriegn financing with an additional $2.1 billion in financing in 1981. Both of these elements will have to be present and reinforce each other for the Polish renewal to continue. Western financing without stabilization is only throwing good money after bad. Without a turn-around in the economy, Poland's financing needs will quickly outstrip the ability of the West to provide further assistance -- even with a substantial CEMA contribution -- and there would be no way for Poland ever to repay. On the other hand, a Polish stabilization plan has little chance of success without the availability of sufficient resources to purchase needed Western imports. Polish industry already suffers from chronic shortages of imported Western intermediate goods and spare parts. The production shortfalls due to these shortages form a vicious circle -- the fall in production of exportable goods reduces Poland's ability to earn foreign currency to make purchases of needed inputs. Poland's difficulty in financing Western foodstuffs could also threaten internal cohesion, as it may lead to further disruptive work stoppages and greater internal strife over the implementation of economic reforms.

Assuming Poland can find sufficient financing in 1981 to avoid a disastrous decline in imports and meets its ambitious balance of payments targets, next year should be more easily managed. Following an official and private rescheduling in 1982, Poland would require approximately $3.8 billion in financial or export credits. With Poland on track on its stabilization program for 1981 and 1982, sufficient progress should be made by 1983 to allow replacement of the bulk of official financial assistance by commercially motivated private and official credits.

Prospects for Stabilization

Although the Poles have implemented some important measures, such as the 50 percent increase in prices paid to farmers for agricultural products, Polish authorities have been unable to put together a comprehensive stabilization program. It is clear that any stabilization package would have to be negotiated with solidarity. Thus far, solidarity has blocked piecemeal measures to improve the economy and tied measures which would have an adverse impact on worker living standards to a more comprehensive reform effort. The Polish party leadership, occupied with political turmoil, the internal power struggle and the threat of Warsaw Pact intervention, has not been able to overcome the practical and idealogical obstacles to a comprehensive reform program. In addition, it is not clear how much effective central control can be exercised over the actions of the local bureaucracies that have to implement stabilization measures.

On the brighter side, Walesa has clearly stated that Polish workers are prepared to make "sacrifices" for an economic recovery. Soviet threats of intervention may actually increase Polish workers' willingness to accept lower standards of living. The upcoming party Congress, should it be held, promises to settle the internal dispute in favor of the "reformist" elements. This offers the possibility of sweeping changes in economic policies and removal of local bureaucratic opposition to reform.

In any event, Poland is rapidly approaching the point where the balance of payments will be "stabilized" by the lack of sufficient hard currency financing to cover Poland's import needs. Unless Western imports are more efficiently allocated, the downward spiral of industrial production will accelerate and the chronic food shortages will be exacerbated. In short, Poland will have only a fixed amount of foreign financing in 1981, so they will be unable to run a large trade deficit. If the Poles are lucky, they may receive sufficient financing to run a trade deficit of $700 million, or the targets on their balance of payments. Stabilization, or how efficiently these credits are used, will determine how far GDP will have to decline this year. The ability of Polish authorities to maintain social cohesions and keep the economy going during this period will be crucial for an eventual economic recovery.

The Situation in 1981

The Polish economic situation continues to deteriorate rapidly. Even if Polish authorities succeed in implementing stabilization measures, GNP will fall between 10-15 percent this year. The precipitus fall is due to shortages of imported raw materials, absenteeism, and shorter hours. Shortages of intermediate goods and the lack of work incentives due to increased wages without goods to purchase, need to be corrected if the situation is to be stabilized. This decline may be even greater if Poland does not meet its ambitious balance of payments targets and line up further financing for the second half of the year.

As shown in Table I, after rescheduling by its three major Western creditor groups (the Paris Group governments, other Western governments, and the private banks) and CEMA, Poland will have covered over one-half of its financing needs, leaving about $5.1 billion in hard currency credits to meet minimum import needs and stave off default. We estimate that if Western governments take steps to change the terms of their credits, Poland has already arranged usable financing of $2.7 billion. About $1.4 billion of this total is in European credits which have not been drawn due to requirements for large cash down payments which the Poles cannot afford. As shown below, the U.S. is the single largest contributor to this total thus far this year.

	Usable Credits	Drawn
U.S. *	585	413
CEMA	450	450
FRG	336	0
Canada	235	32
France	180	61
U.K.	146	116
Denmark	110	19
Italy	100	30
Norway	79	34
Belgium	77	7
Austria	60	-
Netherlands	49	-
Sweden	42	30
Japan	30	8
Other	321	-
TOTAL	2479	1200

* includes $113 million as usable credits.

The remaining financing gap is in the range of $2.4 billion. Given the already sizable U.S. contribution this year, particularly in view of our relatively smaller financial and economic ties with Poland, the U.S. position is that the remaining gap should be filled by the Europeans and Soviets.

Neither the Europeans nor the Soviets have shown any enthusiasm for further credits. European performance on credits this year has been particularly disappointing. The major European participants in Polish creditor meetings have pledged slightly less than $1.2 billion. Only some $300 million of this total has actually been drawn this year. At the last creditor meeting on Poland June 1-2, France was the only country to offer further credits -- and this offer only mounted to $60 million. CEMA has reportedly provided $450 million in the first quarter of 1981, but hard figures are not available. The Poles claim that CEMA has decided against providing further hard currency assistance in 1981. Both of these hard line positions may crumble, however, as the Poles run into a financial crunch in the fall.

If the gap is not filled, Polish authorities will face one of two unpalatible choices: (1) to cut back sharply on Western imports; or (2) default on unrescheduled debt service to Western creditors. A sharp cutback on Western imports would in the short run prove the most disruptive. Recurrent food shortages could again bring the political situation to a boil and the shortage of Western intermediate goods would accelerate the economic decline. The alternative would be to default on $700 million in unrescheduled interest due the private banks in the second half of 1981 and $400 million in unrescheduled debt service due official creditors.

There are three sources of funds which Poland may be able to tap to cover their $2.4 billion gap this year: the private banks, CEMA and the Europeans.

The banks are working on their own rescheduling and it appears that principal payments due this year will be deferred. Rather than reschedule, the U.S. banks have decided to roll-over principal repayment through the end of the year. The European banks will meet next week.

At present, it is clear that the private banks are not prepared to accept further exposure in Poland. As a default on interest payments in the second half of the year approaches, however, the pressure to provide additional funds will mount. While banks are loath to reschedule interest, they may be willing to provide sufficient funds to allow the Poles to keep current on a portion of interest payments due in the second quarter. We should not, however, expect any quick agreement to this procedure, particularly from the American banking community. Polish loans are rated as non-performing by U.S. bank regulators, which means Polish exposure must be met in part by a special reserve against bank capital. Any private loans to enable Poland to keep current on interest would probably be handled quietly in negotiations between the Poles and individual banks.

The Soviets have a vital stake in Poland's stability, and an additional CEMA contribution will be a critical element in Poland's ability to close the $2.4 billion gap. Economic chaos in Poland will involve significant costs to the Soviet Union. Poland's financial problems and the Soviet Union's reluctance to open the CEMA "umbrella" has already made the private banks more cautious about lending to Eastern Europe. A Polish economic collapse would erode bank confidence further, although we do not expect a complete credit cut-off. Perhaps more important, Poland's economic difficulties have deprived the Warsaw Pact countries of vital Polish exports, in particular coal deliveries. Finally, further chaos within Poland might force a military intervention, which could impose substantial political and economic costs.

Given the costs of military intervention, the Soviets may find it tempting to use economic leverage to reverse the course of events in Poland, particularly if it appears that Poland is unable to count on the West as an alternative source of credits. The West will have a tricky hand to play here. Poland's financial needs exceed the West's ability to provide assistance. Some gap will have to be left for the Soviets. On the other hand, if the West holds back to prompt a Soviet contribution, Western assistance becomes a hostage to Soviet policy and magnifies Soviet economic leverage.

The Europeans have played a confused role in the Polish financial problem; it would be easy to suspect bad faith, but perhaps they simply have not done their homework. They have been cool towards our attempts to devise strategy towards pressing for a large Soviet contribution and actively resisted our proposal to maximize debt relief this year. At the same time that they have pressed for further U.S. credits, they have done little on their own.

Outlook for 1982

Assuming Poland can get through 1981 without a disastrous decline in Western imports and can regain control of the economy, the situation next year should be more manageable. The levels of Western assistance required to meet the financial gap may prove uncomfortable but should fall well short of assistance levels for 1981.

Assuming the terms of a rescheduling stay the same in 1982, the combined value of a private and official rescheduling would be approximately $5.3 billion, leaving a financing gap of $3.8 billion. Poland's gross financing needs next year should be in the range of $9.0 billion. A good portion of this total can be met with debt relief. Under the same debt relief terms granted in this year's rescheduling (90 percent of principal and interest on credits granted prior to January 1, 1981) an official rescheduling should be worth approximately $3.0 billion. Changes in these terms, however, could increase the value of a rescheduling by $400-500 million. The most significant changes in terms might include:

— changes in the cut-off date of the rescheduling to include credits granted in 1981;

— changes in the percentage of debt covered by rescheduling.

While it was in U.S. financial interest to maximize the amount of debt relief granted in 1981, the same strategy may not hold in 1982, particularly in regard to changes in the cut-off date. Our delegation in Paris managed to exclude $500 million in CCC credits signed in 1981 from the rescheduling. A change in the cut-off date would include them in 1982. Maintenance of January 1, 1981 as the cut-off date would be defensible as standard international practice.

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Financing Gap 1981
(billions of dollars)

Current Account Deficit		$ 3.0
Amortization		7.5
Credits Extended		.2
Short-term Capital Flight		.6
Gross Financing Requirement		11.3
Financing Items of which		8.9
Already Arranged		
Official Rescheduling (Paris Group)	$2.9	
Western Export Credits	.7	
Socialist Assistance (First Quarter)	.7	
Western Financial Credits	.2	
Private Rescheduling	2.4	
Expected		
Undrawn European Export Credits	1.4	
Official Roll-Over (Other Western Governments)	.6	
Financing Gap After Already Arranged and Expected Financing		$ 2.4
Financing Gap Including Only Financing Already Firmly Arranged		$ 4.4

Table II

Financing Gap 1981-1983
(billions of dollars)

	1981	1982	1983
Current Account	$ 3.0	$ 2.5	$ 2.0
Capital Outflows	7.7	6.6	5.8
Short-Term Capital Flight	.6	-	-
Gross Financing Needs	$11.3	$ 9.1	$ 7.8
Financing Item of which			
Official Rescheduling	$ 3.8	$ 3.1	$ 2.2
Private Rescheduling	2.4	2.2	.7
Gap Following Rescheduling	$ 5.1	$ 3.8	$ 4.9
Additional Financing Available			
Export Credits	$ 2.1	-	-
Other Credits	.2	-	-
CEMA AID	.4	-	-
Remaining Gap	$ 2.4	-	-

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